LOCAL GOVERNMENT FINANCE STUDY COMMISSION

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MEETING MINUTES

Meeting Date: November 18, 1998
Meeting Time: 10:00 A.M.
Meeting Place: State House, 200 W. Washington St., Room 404
Meeting City: Indianapolis, Indiana
Meeting Number: 5

Members Present: Sen. Thomas Weatherwax, Chairperson; Sen. James Merritt; Sen. Katie Wolf; Sen. Richard Young; Rep. Markt Lytle; Rep. Claire Leuck; Rep. James Buck; Rep. William Friend; Hon. Herschel Cook; Hon. Howard Hatcher; Karen Large; Judith Anderson; James Murphy; Michael Claytor.

Members Absent: Hon. David Butterfield; Barbara Haas; Hon. William Goffinet; Eugene Hostettler; Stephen Queior; David Bennett.

1. Call to Order

Senator Tom Weatherwax, the Chairman of the Commission, called the meeting to order shortly after 10:00 a.m.

2. State Expenditure Limitation Issues

Senator Weatherwax then recognized Representative Jeff Espich for a discussion of issues related to state expenditure limitations and property tax relief.[1] Representative Espich began his testimony by stating that he believed the General Assembly did not need to increase taxes in order to pay for property tax relief. According to Representative Espich, property tax reduction could be paid for through a combination of three items: (1) revenue enhancements that had been adopted during the preceding decade; (2) greater efficiency and accuracy in budgeting; and (3) the structural surplus in the state budget.

Representative Espich noted that the state now receives nearly $400 million each year from the lottery and from gambling taxes that it did not receive ten years ago. He also stated that the income tax had been increased 0.4% to pay for the "A+ Program", and that this tax increase now raises over $400 million per year while the annual program costs are slightly less than $200 million. Representative Espich also pointed out that approximately $200 million in appropriations had been reverted during the preceding state fiscal year, which is $150 million more than was estimated by the State Budget Agency when the budget was passed. He described a "truth in budgeting" proposal, and he said that it would provide a closer match between the amounts budgeted and the amounts actually expended.

Representative Espich also described proposals to: (1) cut 5%, or $71.7 million each year, from the administrative operating base of state government; and (2) make additional state money available for tax relief purposes by limiting the growth in state spending below the historic average. He commented that consolidation of various state agencies into the Family and Social Services Administration had been a successful consolidation of state government operations, and he suggested that money could also be saved by the consolidation of certain other state functions into a Public Safety Administration, an Office of Administration and Budget, and a Department of Motor Vehicles.

Representative Espich next described additional budget efficiency proposals concerning: (1) the establishment of an innovation fund to provide a reward for innovative cost-saving suggestions by agencies or individuals; and (2) a review of state government to determine where competitive bidding or other private sector competition could save money.

Representative Espich then explained a number of scenarios concerning limits on the rate of growth of state government expenditures. He stated that: (1) if the base growth rate of state expenditures were decreased from 5.3% to 5.0%, it would eventually allow $1.01 billion to be used for tax relief or other purposes each year; (2) if the base growth

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[1] Copies of Representative Espich's proposal, "Delivering Permanent Tax Relief," are on file in the Legislative Information Center, Room 230, State House, Indianapolis, Indiana 46204. The telephone number of the Legislative Information Center is (317) 232-9856, and the mailing address is 200 W. Washington St., Suite 301, Indianapolis, Indiana 46204-2789.

rate were decreased from 5.3% to 4.5%, it would eventually allow $1.45 billion to be used for tax relief or other purposes each year; and (3) if the base growth rate were decreased from 5.3% to 3.5% (which is roughly equal to the combined percentage increases in inflation and Indiana population), it would eventually allow $2.175 billion to be used for tax relief or other purposes each year.

Senator Weatherwax next recognized Mr. Jim Knoop of the Indiana Policy Review. Mr. Knoop provided the Commission with written material describing property tax increases in Indiana over the period 1982 - 1997. He also provided the Commission with information on increases in state appropriations during the past ten years.[2]

Mr. Knoop began his testimony by stating that he believed state and local government should not necessarily grow each year. He noted that during the period 1982 through 1997, property tax revenue had increased 166%, although the Consumer Price Index had increased only 66.3%. Mr. Knoop explained that much of this growth in property tax revenue had resulted from the generally favorable economic conditions since 1982, and he pointed out that assessed valuation had increased 103.9% during that period. He also commented that in every year since 1982, total property tax levies had grown faster than the annual increases in the Consumer Price Index.

Mr. Knoop then reviewed the history of state appropriations during the past ten years. He began by explaining that in 1989 the total state appropriations were approximately $8.224 billion, but that by 1998 state appropriations had increased by $5.625 billion to approximately $13.849 billion. He stated that this amounted to a 68% increase in appropriations during the past ten years, while the Consumer Price Index had increased only 39% during that period. Mr. Knoop also noted that this increase in state appropriations had occurred without any rate increases in the major state taxes. He commented that in every year during the past decade, except for 1995, the annual increase in state spending had been greater than the growth of the Consumer Price Index.

Representative Claire Leuck noted that state appropriations and revenue had increased during the past decade, but that the overall price level had increased during that period as well. Rep. Leuck questioned Mr. Knoop concerning the factors that led to the growth in state appropriations, and Mr. Knoop commented that he believed there is a natural propensity for governmental institutions to grow over time, as those institutions find a way to spend money that has been appropriated to them. He also noted that some of the growth has occurred in areas, such as corrections, in which most people believed spending should be increased. Representative Markt Lytle asked Mr. Knoop if his data took into account the fact that some state spending is done in order to match or leverage money from the federal government, and Mr. Knoop

[2]Copies of Mr. Knoop's material are on file in the Legislative Information Center. See footnote 1.

responded that he had not specifically designated this type of state spending.

3. Taxation of Railroad Car Companies

Senator Weatherwax then reviewed PD 3620, which had been discussed by the Commission at its meeting on October 28, 1998. He explained that the draft would do the following:

(A) Provide that the property taxes derived from indefinite-situs distributable property of railroad car companies are deposited in the State General Fund, instead of the Commuter Rail Service Fund.

(B) Grant railroad car companies a credit against their indefinite-situs property tax liability for railroad car maintenance and improvement expenditures made in Indiana. This credit would be equal to 50% of the qualified expenditures made by the taxpayer in the taxable year.

(C) Provide that 0.17% of state sales tax revenue is distributed to the Commuter Rail Service Fund. This would be roughly equal to what the Northern Indiana Commuter Transportation District currently receives from property taxes deposited into the Commuter Rail Service Fund.[3]

Senator Weatherwax commented that the draft would provide an incentive for railroad car maintenance companies to expand their business in Indiana, thereby creating more jobs. After a motion to recommend PD 3620 was made and seconded, the Commission voted 7-0 to recommend the draft to the General Assembly.

4. School Property Tax Issues

Senator Weatherwax then asked Representative Jim Buck to explain PD 3747, which contained a preliminary version of school property tax relief proposals described by Representative Buck at the Commission's meeting on October 28, 1998.

PD 3747 would do the following:

(1) Eliminate the authority of a school corporation to impose a general fund property tax levy for the general operation and maintenance of the school corporation.

(2) Eliminate the authority of a school corporation to impose a transportation fund property tax levy.

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[3]Copies of PD 3620 are on file in the Legislative Information Center. See footnote 1.

(3) Require a school corporation to impose a local income tax for education of not more than 0.6%.

(4) Limit annual increases in state expenditures to the lesser of: (a) the increase in inflation and population; or (b) 4%.

(5) Limit annual increases in appropriations of political subdivisions, including school corporations, to the lesser of 4% or the percentage changes in population and inflation.

(6) Provide a state tuition support formula that provides an amount equal to the difference between: (a) the school corporation's ADM multiplied by $5,000; and (b) the amount that the school corporation can raise from a local income tax for education of 0.6% and from certain other revenue sources.

(7) Establish the state school reserve fund and appropriate $150,000,000 to the fund from the state general fund.[4]

Representative Buck noted that the 0.6% tax rate used in the draft might have to be adjusted as more data is gathered, but the state guarantee of the difference between $5,000 per student and what the school district could raise by imposing the maximum tax rate would not change.

After Representative Buck's explanation and in response to a question from the Commission, Mr. Robert Kraft of the Indiana Farm Bureau stated that while he had not gone through the details of PD 3747, the Indiana Farm Bureau did support the principle of replacing school general fund property taxes with a local income tax for education. Mr. Kraft stated that such a local income tax would much better reflect a taxpayer's ability to pay. He noted that 1998, a year in which commodity prices received by farmers were extremely low, highlighted the unfair impact property taxes had on farmers.

Representative Claire Leuck questioned Representative Buck concerning the disparities between different school districts' ability to raise the necessary revenue through a local income tax. Representative Buck responded that the tuition support formula would be structured to make up the difference between: (1) what the school corporation could raise through a local income tax; and (2) an amount equal to $5,000 per student.

Senator Jim Merritt asked Representative Buck whether the proposed local income tax for education would include provisions for school corporations with a growing

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[4]Copies of PD 3747 are on file in the Legislative Information Center. See footnote 1.

enrollment. Representative Buck replied that those school corporations would not be able to raise the local income tax rate above the state-wide maximum rate.

Mr. Kevin Brinegar of the Indiana Chamber of Commerce testified that, while he had not reviewed the details of the draft, the Chamber agreed with the principle of achieving property tax reform by eliminating entire property tax levies. Mr. Brinegar stated that the elimination of entire property tax levies was the best way to ensure that any property tax reform was permanent.

Mr. Tom Morton of the Indiana Association of Cities and Towns testified that the spending controls included in the draft were not wise or workable with respect to municipalities, and that local elected officials should make the expenditure decisions. He stated that there are different revenue sources for local governments and for the state, and that the spending of most municipalities is effectively restrained by the limitations placed on their revenue growth.

Mr. Morton said that cities and towns represent approximately 16% of statewide property taxes. He also commented that the Consumer Price Index, which the draft uses as a factor in determining allowable expenditures, is not a good measure of cost increases incurred by local governments. He also stated that the spending of smaller municipalities fluctuates a great deal on a year-to-year basis.

Senator Weatherwax then briefly described PD 3739, which contained a preliminary version of school property tax relief proposals offered for discussion purposes by Senator Weatherwax at the Commission's meeting on October 28, 1998.

PD 3739 would do the following:

(1) Eliminate the authority of a school corporation to impose a general fund property tax levy for the general operation and maintenance of the school corporation.

(2) Eliminate the authority of a school corporation to impose a transportation fund property tax levy.

(3) Increase the individual adjusted gross income tax rate from 3.4% to 3.9%.

(4) Increase the corporate adjusted gross income tax rate from 3.4% to 4.2%.

(5) Increase the corporate supplemental net income tax rate from 4.5% to 5.3%.

(6) Increase the financial institutions tax rate from 8.5% to 8.6%.

(7) Increase the sales tax rate from 5.0% to 5.5%, and extend the sales tax to

services other than medical and legal services.

Mr. Michael Claytor, a lay member on the Commission, stated that he believed property tax reduction was a good idea, but that its effect on the use of tax increment financing as an economic development tool needs further study. He noted that any reduction in property taxes would reduce the economic value of the tax increment. He also commented that he believed many units of local government were in fact doing a good job of keeping their property taxes from increasing.

Mayor Herschel Cook, a lay member of the Commission, noted that according to a quick calculation he had made, the provisions in PD 3739 would increase his overall tax payments.

Representative Leuck noted that according to projections of the overall tax burden under PD 3739, homeowners and farmers, as an aggregate category, would pay more.

After further Commission discussion, a motion was made and seconded to recommend that as part of any discussions concerning tax restructuring, the General Assembly should also consider the option of: (1) authorizing a local income tax for education; and (2) eliminating school general fund and transportation property tax levies. The proposed recommendation was adopted 7-0.

5. Adoption of the Commission's Final Report

The Commission voted 6-0 to adopt the Proposed Final Report, with the additions adopted earlier in the meeting, as the Commission's Final Report for the 1998 interim.[5]

6. Correction to Previous Minutes

In the minutes for the October 28, 1998, meeting of the Commission, Mayor Howard Hatcher should have been listed as being present for the meeting.

7. Adjournment

Senator Weatherwax then thanked the members of the Commission for their service and for their comments and suggestions. There being no further business, Senator Weatherwax then adjourned the Commission's final meeting.

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[5]Copies of the Commission's Proposed Final Report are on file in the Legislative Information Center. See footnote 1.